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In the Supreme Court of the United States

October Term, 1984

IN RE: GEORGE E. EWING, Debtor
DONALD R. CALAIARO, Trustee,
Petitioner,

vs.

PITTSBURGH NATIONAL BANK and
COVENTRY CARE, INC.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Brief of Respondent, Coventry Care, Inc. in Opposition to Petition for Writ of Certiorari

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COUNTERSTATEMENT OF THE CASE

The Respondent, Coventry Care, Inc. ("Coventry"), agrees generally with Petitioner's Statement Of The Case, except that Respondent has set forth *as facts* certain statements which are not facts of this case and which to the knowledge of Coventry are not correct.

In the Statement Of The Case, Petition, p.12, second paragraph, Petitioner states that the sale of the shares was for "an amount equal to the balance of the unpaid principal of $61,602.10 plus interest". To Coventry's knowledge, there remains a balance due on the Debtor's debt to Pittsburgh National Bank ("PNB") in excess of the $72,500.00 sale price of the shares.

Another Statement which is not a fact of this case appears in Petitioner's Argument on page 18 of the Petition. Petitioner states that "the debtor had an equitable interest in the stock beyond the value needed to secure repayment of the loan". It is not a fact of this case that the value of the stock was greater than the total indebtedness of debtor through Pittsburgh National Bank.

THE QUESTION PRESENTED FOR REVIEW

Is a sale of collateral by a secured creditor pursuant to Article 9 of the Pennsylvania Uniform Commercial Code within one year of bankruptcy a transfer under §548 of the Bankruptcy Code when the creditor's security interest in the collateral was perfected more than one year prior to institution of bankruptcy?

REASONS FOR DENYING THE WRIT

Rule 17 of this Court provides that "A review on Writ of Certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor". The Argument below will make clear that there are no special or important reasons which warrant review by this Court of the decision by the Court below because the Third Circuit's decision, which affirmed that of the District Court, is clearly correct and deals at bottom with questions of routine State law as opposed to important questions of federal law or questions of great public importance. Consequently, the grounds asserted by Petitioner for the exercise of this Court's discretion are wholly without foundation or merit. A review of the arguments raised by Petitioner and a presentation of the reasons in support of denial of the Writ, are presented separately for each issue below.

I. A WRIT OF CERTIORARI SHOULD NOT BE GRANTED EXCEPT WHERE THERE ARE SPECIAL AND IMPORTANT REASONS THEREFOR.

In *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70 (1955), this Court initially granted certiorari and thereafter vacated the writ as improvidently granted. Although *Rice* was decided under former Supreme Court Rule 19, the reasoning therein is equally apt to present Rule 17. This Court said the following on page 74:

> A federal question raised by a petitioner may be "of substance" in the sense that, abstractly considered, it may present an intellectually interesting and solid problem. But this Court does not sit to satisfy a scholarly interest in such issues. Nor does it sit for the

benefit of the particular litigants. [Citations deleted] "Special and important reasons" imply a reach to a problem beyond the academic or the episodic.

In *Rice, supra,* after the grant of certiorari and argument, it was brought to the Court's attention that an Iowa statute enacted after commencement of the litigation changed the law of Iowa which was the very subject of the litigation. This Court noted on page 73 that the statute barred the ultimate question presented in the case from again arising in the State. This Court said on pages 76-77 "Had the statute been properly brought to our attention and the case thereby put into proper focus, the case would have assumed such an isolated significance that it would have hardly have been brought here in the first instance". The same reasoning is applicable to the case at bar. As the Petitioner admits on pages 15-16 of the Petition, Congress has amended Bankruptcy Code §548(a) since inception of this litigation. The amendment is set forth on page 16 of the Petition and provides, in effect, that a trustee may avoid a transfer of the debtor's interest in property regardless of whether such transfer was *voluntarily* or *involuntarily* made. Therefore, the outcome of this case is of concern only to the parties herein so that the case is now at best of isolated significance. Further, it is respectfully submitted that the case at bar does not even rise to the significance of *Rice, supra,* because *Rice,* at least, addressed a question of constitutional dimensions. This case and the few similar to it address only a question which at bottom is one of fair market valuation in State creditor foreclosure proceedings.

The Petitioner's assertion that certiorari should be granted in order to reconcile a split among the Circuits with respect to the subject issue is without merit.

The Petitioner cited *Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547 (5th Cir. 1981) *cert. denied* 452 U.S. 1164 (1982); *Durrett v. Washington National Ins. Co.*, 621 F.2d 201 (5th Cir. 1980); and In *Re Hulm*, 738 F.2d 323 (8th Cir. 1984) *cert. denied*, _____ U.S. _____, 105 S.Ct. 398 (1984) as cases which support Petitioner's position herein. Both *Abramson* and *Durrett* are, at least, initially distinguishable for the following reasons.

§548(d)(1) of the Bankruptcy Code, 11 U.S.C.A. §548(d)(1), specifically defined "transfer" for purposes of §548, as follows:

> For purposes of this section, a transfer is made when such transfer becomes so far perfected that a bona fide purchaser from the debtor against whom such transfer could have been perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer occurs immediately before the date of the filing of the petition.

It is significant that neither *Abramson* nor *Durrett* addressed the question of the significance of §548(d)(1). The absence of such consideration in *Abramson* and *Durrett* is significant because in the case at bar, the District Court predicated its decision in principal part upon its interpretation of §548(d)(1). *See* Appendix to Petition, pps. A-37 and A-41. This Court does not have the benefit of the views of the Fifth Circuit panels in *Abramson* and *Durrett* as to their interpretation of §548(d)(1). Therefore, to that extent, there is not the significant split among the Circuits to which Petitioner refers.

Also, both *Abramson* and *Durrett* were decided under the Bankruptcy Act in effect prior to enactment of the Bankruptcy Code in 1978.

There is a split among the Circuits, but Coventry respectfully directs this Court's attention to the fact that Petitioner did not cite the one Circuit case which is in accord with the decision of the District Court, as affirmed by the Third Circuit herein. *In Madrid v. Lawyers Title Insurance Corp.*, 725 F.2d 1197 (9th Cir. 1984), *cert. denied*, _____ U.S. _____, 105 S.Ct. 125 (1984), this Court addressed specifically the significance of §548(d)(1) and distinguished *Abramson* and *Durrett* by holding on page 1201 that the "narrower definition of transfer set out in §548(d)(1)" was determinative of the issue as to when transfer occurred for purposes of a trustee's right of avoidance under §548.

The true split among the Circuits is that created by the decision of the Eighth Circuit in *In Re Hulm, supra.*

Hulm did consider §548(d)(1) and concluded that there could be more than one transfer thereunder, and that any of such transfers which occurred within the one year period preceding bankruptcy was subject to avoidance.

Therefore, to the extent that there is a split among Circuits it is that the Third Circuit (the case at bar) and the Ninth Circuit *(Madrid)* differ in their interpretation of §548(d)(1) from that of the Eighth Circuit *(Hulm).* It is respectfully submitted that this Court has determined most recently that there is no special or important reason which would warrant review of the subject issue because it has denied certiorari in both *Madrid* and *Hulm.* There are no special circumstances or reasons present in the instant case which warrant reversal of such prior determinations.

II. THE INTENT OF CONGRESS IN AMENDING §548 OF THE BANKRUPTCY CODE IN 1984 IS IRRELEVANT TO THE PRESENT CASE, AND IN ANY EVENT, DOES NOT REPRESENT A SPECIAL AND IMPORTANT REASON FOR GRANT OF CERTIORARI.

The Petition does not set forth any legislative history, case law or other applicable reasons in support of the assertion that the Third Circuit's affirmance of the District Court's decision herein was contrary to the intent of Congress. The addition of the word "involuntarily" in §548(a) by Congress in 1984 does not necessarily indicate the intent of Congress in passage of former §548(a). To the contrary, the 1984 amendment is equally susceptible to the interpretation that in 1984 Congress intended to *change* the law rather than *clarify* it as asserted by Petitioner. If this Court were to grant certiorari solely to determine the intent of Congress in enacting former §548 of the Bankruptcy Code, 11 U.S.C.A. §548 (1979), it would be engaging in an academic exercise of the sort which resulted in vacation of the Writ previously granted in *Rice, supra.*

III. THE DECISION OF THE THIRD CIRCUIT WHICH AFFIRMED THE DECISION OF THE DISTRICT COURT IS NOT IN CONFLICT WITH PENNSYLVANIA LAW RELATING TO PROPERTY RIGHTS OF DEBTORS.

The District Court decided only one question of State law. That question was as follows: When does a creditor's perfection of a security interest in securities occur? The District Court concluded that perfection occurs when the creditor is given possession of the securities. *See Appendix to Petition,* pgs. A-37 through A-41.

The determination of such question was necessary because a "transfer" is made under §548(d)(1), *supra,* when the "transfer" is perfected under State law. Contrary to Petitioner's assertion in its Argument III, the District Court did not determine that the debtor was not entitled to any excess proceeds which might have resulted from PNB's sale of the pledged stock. *The District Court only determined when the pledge was perfected under State law, and even the Petitioner does not challenge that conclusion.*

A patent review of the District Court's opinion, which was affirmed by the Court of Appeals, manifests clearly that the District Court did not make any of the determinations of law referred by Petitioner in its Argument III.

In all events, Rule 17 of this Court which sets forth considerations governing review on certiorari does not include an alleged mis-interpretation of State law by a federal court. Rule 17 essentially provides that the character of reasons that will be considered relate essentially to conflicts among decisions on important federal questions. Therefore, Petitioner's Argument III is without merit.

IV. A. CERTIORARI SHOULD BE DENIED BECAUSE UNDER SECTION 548(d)(1) OF THE BANKRUPTCY CODE A TRANSFER OCCURS WHEN NO SUBSEQUENT PURCHASER FROM OR CREDITOR OF THE DEBTOR CAN ACQUIRE AN INTEREST IN THE TRANSFERRED PROPERTY SUPERIOR TO THAT OF THE TRANSFEREE.

Section 548(d)(1), *supra,* which establishes the time of the making of a transfer for purposes of §548 states, as follows:

> "... a transfer is made when the transfer becomes so far perfected that a bona fide purchaser from the debtor against whom such transfer could have been perfected cannot acquire an interest in the property transferred superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer occurs immediately before the date of the filing of the petition."

Federal law determines whether a particular occurrence is a transfer for bankruptcy purposes, while state law determines the time and method of perfection. *Madrid, supra. Dean Witter Reynolds, Inc. v. MacQuown,* 717 F.2d 859 (3rd Cir. 1983) also holds by implication that state law determines the time and method of perfection.

The property of the Debtor in this case was common stock, which is a "security" under the Uniform Commercial Code ("UCC") of Pennsylvania. 13 Pa.C.S.A. 8102(a) and/or 8102(c).

The UCC defines an "instrument" to include, *inter alia,* a "security" (as defined in 13 Pa.C.S.A. 8102, *supra*). 13 Pa.C.S.A. 9105(g).

Under the UCC, perfection of a security interest in instruments is effected by delivery of possession of the instrument to the secured party as set forth in 13 Pa. C.S.A. §9304(1) which provides in relevant part, as follows:

> ... A security interest in instruments ... can be perfected only by the secured party's taking possession ....

Thus, under state law the transfer was perfected by delivery of the securities which occurred outside of the one

year pre-petition period. Opinion of District Court, Appendix to Petition, A-36.

Madrid, supra, is a case essentially identical to the instant case. It involved a foreclosure sale of real estate, but aside from the fact that the case at bar involves securities, the issue and principles are the same. In *Madrid,* the debtor purchased a home financed by first and second deeds of trust. The debtor defaulted under both deeds, and the trustee under the second deed caused the property to be sold at a non-judicial foreclosure sale. *Perfection of the second deed of trust (accomplished by recording) occurred more than one year prior to filing of the bankruptcy Petition.* Seven days after the foreclosure sale, the debtor filed a Petition for reorganization and instituted an action in Bankruptcy Court to set aside the foreclosure sale. The question addressed by the lower courts was whether there had been a transfer of Madrid's property interest within one year prior to filing of the bankruptcy Petition.

After exhaustive analysis, the *Madrid* Court concluded that for §548 purposes the applicable transfer was perfection of the beneficiary's rights under the deed of trust, which transfer was effected more than one year prior to filing of the Bankruptcy Petition, and thus was not avoidable under §548. The Court's analysis included the following review:

Historical Review

The Court noted that the modern law of fraudulent conveyances derives from the 1570 English enactment of 13 Eliz., Ch. 5, which was passed for the protection of creditors, and gave creditors, *inter alia,* the power to avoid conveyances and transfers made to hinder, delay or defraud creditors. Such provisions have been essentially

reenacted in the bankruptcy laws of the United States through and including §548 of the current Bankruptcy Code. The Court stated that:

> "In our short historical review of the fraudulent conveyance statutes we have found no evidence that the lineal ancestors of §548(a)(2) were to be used to attack a secured creditor's enforcement of a lien as a constructive fraudulent conveyance. These statutes instead provide authority for the proposition that conveyances are set aside when there is actual fraud or a situation indicative of fraud, such as the transfer of property for less than reasonable equivalence." *Madrid, supra* at 1200.

Legislative History

The Court reviewed the legislative history of §548 and concluded that the enforcement of a valid lien was not intended to be covered by such section. The Court noted that the Uniform Fraudulent Conveyance Act, a predecessor of constructive fraudulent conveyance statutes, contained no provision similar to §(d)(1) of §548 which defined time of transfer. *Madrid, supra,* at 1200. The Court queried why Congress added such a provision, and concluded as follows:

> "The answer lies in the legislative history, which demonstrates that by defining transfer for fraudulent conveyance purposes in terms of time of perfection, Congress effected two purposes: (1) time of perfection served as the pivotal point in computing the reachback period during which the bankruptcy trustee could set aside fraudulent conveyances; and (2) a secret, i.e., unperfected transfer would not escape the trustee's avoidance powers by the trustee's failure to attack it within the reach-back period, since an

unperfected transfer was not deemed a transfer for §67d purposes. H.Rep. No. 409, 75 the Cong., 1st Sess. 31-34 (1937). Again, the workings of Congress display no intent to treat lien enforcement activities as constructive fraudulent conveyances." *Madrid, supra,* at 1200.

Time of Perfection

The Court concluded that a transfer occurred when the deed of trust was perfected under state law. Therefore, the Court concluded further that since perfection occurred more than one year prior to institution of the bankruptcy proceeding, the transfer was not subject to attack under §548.

Policy Considerations

The Court stated that the debtor was seeking to create a right to redeem real property previously sold at foreclosure proceedings. The Court concluded that creating such a redemption right under bankruptcy laws will adversely affect commercial and real estate laws, long within the domain of the states. Creating a federal *de facto* right of redemption under the bankruptcy laws is clearly contrary to Nevada real property law". Madrid, *supra,* at 1202. The same conclusion is applicable to the Pennsylvania Uniform Commercial Code; i.e., the trustee in the case at bar seeks to create a right, in effect, to redeem personal property previously sold in conformity with Article 9 of the UCC, despite the fact that no such right of redemption exists under the UCC or any other applicable state law. Further, the same policy considerations are applicable to

UCC sales as to foreclosure sales of real estate. For example, participation at such sales would be chilled significantly, and creditors would be far less willing to lend funds on the security of even common stock.

Fifth Circuit Precedent

The Madrid Court reviewed *Durrett, supra* and *Abramson, supra,* and rejected the reasoning and conclusions of both such cases. It is respectfully submitted that the *Madrid* court correctly distinguished *Durrett* and *Abramson.* The Fifth Circuit held in each of such cases that the transfer occurred within the one year period prior to bankruptcy, basing such conclusion upon the broad definition of "transfer" set forth in §11 U.S.C. 1(30) of the Bankruptcy Act of 1938. A similar broad definition of "transfer" is found in §101(40) of the Bankruptcy Code of 1978, 11 U.S.C.A. §101(40) (1979) (amended and renumbered as §101(48) 1984). The Petitioner here relies solely upon such broad definition of transfer. The *Madrid* court noted that the definition of "transfer" in §1(30) was extremely broad, when contrasted with the narrower, more specific definition of "transfer" set forth in §548(d)(1), and said on Page 1201 that "If we were to apply this definition to the case at bar, we would be ignoring the applicable, narrower definition of transfer set out in §548(d)(1). Finally, the *Madrid* court agreed with the dissent in *Abramson supra,* which held that a foreclosure sale is not a transfer by a debtor as required by §548(a), but rather is an involuntary conveyance triggered by the debtor's failure to fulfill some obligation to the creditor. Coventry Care makes the same argument in Argument B below.

It is most important to note again that neither *Durrett* nor *Abramson* addressed the significance of §548(d)(1) and

the definition of "transfer" contained therein. Therefore, this Court does not have the benefit of the Fifth Circuit's views on the meaning of that important section.

In *Dean Witter Reynolds, supra,* the debtor became indebted to a brokerage firm. The debtor suffered substantial losses in 1976. In 1977 the debtor and his wife executed a deed which conveyed their family residence, held by them as tenants by the entireties to the wife alone. There was no consideration for the conveyance, and the deed was not recorded until June 13, 1979. The wife died in December 1979. The plaintiff had obtained a $200,000 judgment against the defendant-debtor on November 13, 1978. One week later the defendant-debtor filed a Petition for bankruptcy. The plaintiff-creditor filed a Complaint in the Bankruptcy Court contending that under §14(c) of the Bankruptcy Act of 1938 that the debtor should not be discharged. The Third Circuit concluded on Page 863 that a transfer is complete for purposes of §14(c)(4) when it is good against bona fide purchasers. The Court said as follows on Page 863:

> "Under Pennsylvania Law, a transfer of real property is good as against a subsequent bona fide purchaser, mortgagee or judgment holder when the deed is recorded. Pa. Stat. Ann. Tit. 21, §351 (Purdon 1955)."

The reasoning in Dean Witter is patently applicable here; i.e., a transfer occurs when perfection thereof is completed. In the case at bar, such transfer was perfected by delivery of possession of the securities, after which time no purchaser from the debtor could have acquired an interest superior to that of PNB in such securities.

Under Pennsylvania law and therefore under §548, it is clear that "transfer" of the stock occurred when PNB perfected its security interest therein by obtaining possession thereof on September 30, 1977, approximately 2 years and 10 months prior to Debtor's bankruptcy filing in August, 1980. Therefore, the foreclosure sale held on April 10, 1980 is not subject to avoidance under §548.

B. A TRANSFER UNDER FORMER §548 MUST BE BY THE DEBTOR, AND THEREFORE THE SALE OF COLLATERAL BY A SECURED CREDITOR WAS NOT WITHIN THE PROVISIONS OF §548.

An examination of the relevant provisions of former §548 patently reveals that the debtor must have been the seller or otherwise a participant in the transaction for the transaction to be subject to that section.

Section 548(a) reads as follows:

> "(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, *if the debtor* [emphasis added]

The above emphasized language "if the debtor" establishes unequivocally that actions of the debtor and only the debtor can effect a transfer which is avoidable under the section.

In *Madrid*, supra, the concurring opinion by Judge Farris was predicated solely upon the issue of whether an avoidable transfer under §548 had to be by the debtor. Judge Farris stated that:

"The problem with Madrid's argument is that she did not transfer the property. After she defaulted, the foreclosure proceeded without her participation or consent. I recognize that the definition of "transfer" at 11 U.S.C. §101(41)... includes "involuntary" transfers, but §548 permits the trustee to set aside a transfer "if the *debtor*... received less than a reasonably equivalent value" (emphasis added). This language contemplates that the debtor was the seller or otherwise participated in the transaction.

...One cannot presume fraud by the debtor in a transaction where the debtor was not a party. Section 67(d) of the prior Bankruptcy Act, virtually identical in all substantive respects to the present §548, applied only to "transfers made... by debtors." If the language of §548 does not reflect the debtor's active role as clearly as that of its predecessor, the purpose and origin of the present statute give clarity of meaning to phrases that might otherwise be ambiguous. I would therefore hold that only transfers where the bankrupt was a participant can be set aside for absence of "reasonably equivalent value". *Madrid, supra,* at 1203-04 (concurring opinion, Farris, J.)

In any event, as set forth in Argument I hereof, §548(a) was amended in 1984 and the above argument is now of concern only to the parties herein.

CONCLUSION

There are no special or important reasons why certiorari should be granted herein. This Court has recently denied certiorari in two cases containing the same basic issue as is present in the subject case. In addition, the statutory provisions which are the subject of this case have been amended since institution of the litigation and

accordingly the result in this case would be a matter of concern only to the litigants.

In all events, the decision of the Court of Appeals for the Third Circuit, affirming the decision of the District Court, was correct as a matter of law.

Therefore, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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